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USDA FOR SECRETARY JOHANNES
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SUBJECT: HONDURAS SCENESETTER FOR USDA SECRETARY JOHANNES

11. (SBU) Summary: As you prepare to visit Tegucigalpa, relations between the United States and Honduras are generally good. President Zelaya considers himself a friend of the United States, and Honduras generally supports U.S. positions on major international issues, including the War on Terrorism. But Zelaya's administration has expressed open irritation and defensiveness about the USG's increasing focus on corruption in Honduras, which may soon affect Honduras continued eligibility for Millennium Challenge Account funding. Your interlocutors may also raise concerns about possible safeguards on Honduran socks, a proposed U.S. tax increase on domestic and international tobacco products, which would affect exports of Honduran cigars, and deportations of Hondurans living illegally in the United States. CAFTA entered into force for Honduras in April 2006, but Honduras has been slow to implement its CAFTA obligations, and exports to the United States were actually down slightly in the first year. Meeting U.S. sanitary and phytosanitary requirements for agricultural exports and improving the Honduran investment climate are major obstacles to reaping the benefits of CAFTA. An apparently off-the-cuff proposal by the Agriculture Minister earlier this year to ban genetically modified crops looks to be dead for the time being. A recent visit by Brazilian President Lula has sparked interest in developing biofuels in Honduras. President Bush discussed biofuels with Zelaya during their last meeting in August 2006. End Summary.

Political Backdrop

12. (U) Honduras faces many challenges, including corruption, unemployment, high levels of violent crime, a highly skewed distribution of income, and a weak judicial system. With a per capita income of approximately USD 1000, Honduras is the third poorest country in the Western Hemisphere. Two-thirds of Hondurans live in poverty, and average education levels are very low. Honduras has the highest rate of HIV/AIDS in Central America. The GOH estimates that approximately one million Hondurans out of a total population of 7 million live in the United States, about 600,000 of whom are undocumented. Immigration issues thus rank high on the bilateral agenda.

13. (SBU) Honduras is a transit country for shipments of cocaine flowing north from South America, predominantly by sea. U.S. and Honduran counternarcotics police and military units actively monitor the transshipment of drugs through the country via air, land and sea routes. The GOH cooperates with the USG in investigating and interdicting narcotics trafficking but faces significant obstacles in funding, a weak and corrupt judicial system with heavy caseloads, lack

of coordination, and inadequate leadership.

Corruption

¶4. (SBU) Honduras is one of the most corrupt countries in the Western Hemisphere and was recently ranked 121 out of 163 countries surveyed by Transparency International. Only Ecuador, Haiti, and Venezuela scored lower in the Western Hemisphere. U.S. policy and statements against corruption have struck a nerve here. The GOH recently passed two important laws that should aid in the fight against corruption: the Transparency Law will give public access to more of the government's dealings and allow the public to obtain information about ministries and agencies; and the new Civil Procedure Code will speed up the judicial process and allow for public oral arguments in civil courts, which have historically been nontransparent. Nonetheless, Honduras's score on the corruption indicators used to determine eligibility for Millennium Challenge Account funding have recently worsened, putting in jeopardy more than USD 200 million in MCA funding. Corruption is particularly rife in the state-owned telecommunications and electricity industries.

Crime

¶5. (U) Personal security is a serious concern for all Hondurans and foreigners residing in Honduras. Violent crime, particularly homicides and various gang-related crimes, is extremely high. According to official Honduran figures, the country has a murder rate of 23.1 per 100,000

TEGUCIGALP 00001484 002 OF 005

inhabitants (compared to the average murder-rate worldwide of 8.8). The police estimate that over half the murders can be attributed to youth gangs that claim over 36,000 members in Honduras. Public support for forceful government actions remains strong. Although the Zelaya administration can claim some credit for a small reduction in the number of violent deaths in Honduras, the country remains one of the most dangerous places in the Western Hemisphere.

President Zelaya

¶6. (SBU) After more than a year and a half in office, the record of accomplishments of President Manuel (Mel) Zelaya, with whom you will meet September 6, is mixed. Zelaya was elected on a platform of "Citizen Power" and the plan of achieving a smaller central government with more power at the local level. But his first year in office has seen a consolidation of power in his hands and those of several close advisors. He claims to favor government transparency, and signed into law in 2006 a transparency bill to promote public access to information. But corruption in Honduras remains rampant. While Zelaya considers himself a friend of the USG, his personality, administration, and populist policies -- as reflected by his proposal to effectively nationalize the distribution of petroleum products -- have made working with him a challenge.

¶7. (SBU) Zelaya sees the integration of Central America as the only viable means Honduras has to meet the challenge of globalization. In addition to ratifying CAFTA and increasing cooperation with neighboring countries, Zelaya intends to develop and strengthen relationships with other countries in the Western Hemisphere, as well as in Asia and Europe. Honduras, together with its Central American partners, is currently negotiating a free trade agreement with the European Union. As a consequence, Honduras, a major banana producer, has opted not to join the United States and other Western Hemisphere countries in a World Trade Organization

dispute with the EU over the EU's banana import policies.

¶8. (SBU) Over the past month, Zelaya has become embroiled in a power play with the President of the Honduran Congress, Roberto Micheletti, who like Zelaya is from the Liberal Party. The dispute centers on competing proposals to reform the Honduran telecommunications market and to regulate the rates on incoming international calls charged by the state telecom company Hondutel. Hondutel has become a major source of graft and corruption in Honduras. Reforming the telecom sector is a CAFTA requirement, but corruption and power politics are standing in the way.

Economic Overview

¶9. (U) After lagging for most of the 1980s and '90s, the Honduran economy has shown steady growth of 4-5 percent over the last five years, thanks in large part to roughly USD 3 billion in external debt forgiveness and huge inflows of remittances from Hondurans residing -- legally and illegally -- in the United States, which amount to about one-fifth of GDP. Inflation has remained moderate at around 6 percent, and the exchange rate has been stable. However, creeping budgetary pressures in the form of subsidies for fuel and electricity and public sector salary demands, in particular from teachers, are causing concern about fiscal sustainability over the medium term. The GOH has committed to applying the resources it has acquired through debt relief to poverty alleviation, but execution has been well below expectations.

¶10. (U) In April 2006, the International Monetary Fund (IMF) was unable to certify GOH compliance with its Poverty Reduction and Growth Facility (PRGF), based largely on concerns about new fiscal policies that loosened fiscal discipline and significantly augmented public sector wages. The PRGF agreement stalled and eventually expired in February 2007. At present Honduras has no formal agreement in place with the IMF.

¶11. (U) The United States is Honduras' largest trading partner, with two-way trade in goods of USD 7 billion in 2006, and the largest source of foreign direct investment. One of the major magnets for foreign investment is the

TEGUCIGALP 00001484 003 OF 005

apparel assembly (maquila) sector, which grew dramatically in the 1990s and now employs more than 130,000 people. However, weak policies and physical and juridical insecurity deter many potential investors. FDI in the maquila sector actually dropped 10 percent in 2006, despite CAFTA.

The Importance of CAFTA

¶12. (U) On March 3, 2005, the Honduran Congress approved CAFTA by an overwhelming margin. The agreement entered into force for Honduras on April 1, 2006. In the 12 months following entry into force, Honduran exports to the United States actually fell slightly compared with the 12 months before the agreement went into effect -- to USD 3.71 billion from USD 3.76 billion. Although 12 months is too short a time on which to judge, many analysts here see this lackluster performance in the first year as evidence that Honduras needs to undertake serious microeconomic reforms and improve its investment climate before it will be able to take advantage of the opportunities offered by CAFTA.

¶13. (SBU) Zelaya's team worked hard to bring CAFTA into force, but has done little since then to take advantage of the opportunities offered by the agreement. Key reforms in energy, telecommunications, and other sectors remain stalled, and policies favoring price controls and state intervention

have weakened the investment climate. The agreement is considered to be absolutely vital to the survival of the textile and apparel sector in Honduras now that worldwide quotas have been eliminated. The agreement's agricultural chapter liberalizes agricultural trade gradually while protecting Honduran farmers from sudden disruptions caused by subsidized imports.

¶14. (SBU) The recent announcement by the U.S. Committee on Implementation of Textile Agreements (CITA) that it was initiating proceedings to determine whether to impose safeguards in response to a recent surge in imports of socks from Honduras has caused a press stir here and may come up in your conversations with Honduran officials. Business groups claim imposition of a safeguard would cost Honduras thousands of jobs and cause investment in the textile and apparel sectors to dry up. CITA will be collecting public comments on the issue until September 20, after which it will have 60 days to decide whether a safeguard is warranted. Under CAFTA, Honduras has the right to demand consultations and to receive compensation in the form of trade concessions on other apparel products. But at this point the GOH is challenging the basis for the safeguard and complaining to us privately that imposing one would be interpreted in Honduras as a betrayal of CAFTA.

Honduran Agriculture

¶15. (U) Agriculture accounts for about 12 percent of Honduran GDP and employs about 35 percent of the workforce. For much of the 20th century, bananas accounted for the vast majority of exports and the bulk of government revenue. But they now amount to just 13 percent of exports. Although there has been some diversification of agricultural production in recent years into more lucrative cash crops (melons, cultivated shrimp, palm oil, oriental vegetables), there remains a large population of subsistence farmers with few economic opportunities other than illegal immigration to the U.S. This is exacerbated by a shift in agricultural policy under the Zelaya Administration to one of subsidizing non-competitive basic grains production.

¶16. (SBU) Earlier this year, apparently without coordination within the GOH, Agriculture Minister Hernandez announced his intention to ban genetically modified seeds from Honduras. This provoked a popular backlash, which forced Hernandez to withdraw the proposal. But Hernandez is reportedly a true believer in the evils of GMO crops.

¶17. (U) More recently, Honduran trade and agriculture interests have sounded an alarm over a proposal in the U.S. Congress to raise the tax on tobacco products -- including Honduran "puro" cigars -- to finance an expansion of children's health insurance. The bill is currently in conference. The Senate version would set the tax on cigars at USD 3; the House version at USD 1. The President opposes

TEGUCIGALP 00001484 004 OF 005

both versions in their current form. An earlier Senate version would have raised the tax to USD 10, and Honduran press are erroneously reporting that as the current proposal.

U.S. Assistance Programs

¶18. (U) In June 2005 Honduras signed a 5-year, USD 215 million Millennium Challenge Compact. It was one of the first countries to sign such a compact. The Compact aims to reduce poverty and promote growth by increasing the productivity and business skills of farmers who operate small and medium-sized farms and by reducing transportation costs between production centers and national, regional and global markets. The goal of the Compact is to increase Honduras'

annual income by an estimated USD 69 million by 2010. Hundreds of small/medium farmers have begun receiving intensive technical assistance in the production and commercialization of high-value agricultural crops. An international project manager is reviewing final designs for upgrades to the country's main highway and working with MCA-Honduras to evaluate proposed improvements to secondary and tertiary roads. Construction is expected to begin in late 2007-early 2008. However, Honduras's recent worsening score on MCC's corruption indicators may result in an imposed remediation plan for Honduras to continue receiving Millennium Challenge Account funding.

¶19. (U) USAID operates a USD 38.8 million program closely aligned with the goals of the MCC. Projects seek to increase the responsiveness and accountability of public institutions and create better models for governance, justice reforms, transparency and participation. There is also a concerted focus on trade policy and support to Honduras in complying with the requirements of CAFTA. USAID strives to bridge agricultural production in rural areas with relatively higher value processing and marketing enterprises in urban centers. An integrated natural resource management program emphasizes sustainable land and water-use, biodiversity, and reduced disaster vulnerability. The health program aims to improve reproductive health, family planning, child survival, prevention of HIV/AIDS, and household food security. USAID is also working to improve the Honduran education system, including through a Centers for Excellence in Teacher Training Presidential Initiative and by assisting GOH efforts to develop quality education standards, testing, and evaluation.

Relations With Neighboring Countries

¶20. (U) The economic relationship between Honduras and El Salvador is growing despite the territorial disputes. The two countries are working together to construct a controversial hydroelectric dam that will provide power to both countries, and with the help of funds from MCC, they are constructing a modern road that will allow El Salvador to send its goods to the Honduran ports on the Caribbean.

¶21. (SBU) The election of Daniel Ortega in Nicaragua was not cause for alarm but only caution on the part of the GOH. Ortega,s claims that he has changed from the 1980s and that he will fully support CAFTA and free trade in the area were well-received by the GOH. However, second thoughts are arising as Ortega welcomes aid from Cuba, Venezuela, and Iran. The GOH is neither embracing nor shunning the Ortega administration, but Zelaya was the only Central American president to personally participate in the recent anniversary of the Sandinista revolution.

¶22. (SBU) Honduras restored relations with Cuba in 2002 after a 40-year break but only recently actively engaged the Cuban government. The Honduran Foreign Minister visited Cuba in October 2006 to sign agreements of friendship and to commence negotiations regarding a maritime boundary. The Cuban Foreign Minister returned the favor and visited Honduras in early March when he promised more medical and education assistance. The first Honduran Ambassador to Cuba in over forty years was named in June 2007. Cuba sent doctors to help Honduras recover from the devastation of Hurricane Mitch in 1998. Since then, Cuba has maintained a brigade of 300 doctors who provide medical assistance to the poor. Cuba also donates medical supplies and offers scholarships for Honduran medical students.

TEGUCIGALP 00001484 005 OF 005

Political/Military Relations

¶23. (SBU) The GOH committed itself to deploying some troops to Haiti in support of the UN peacekeeping operations there, possibly via the Conference on Central American Armed Forces (CFAC), but has yet to do so. Honduras generally supports the United States at the UN, including on such issues as human rights, human cloning, Cuba and the Middle East. Honduras has taken the lead in a number of regional initiatives to enhance cooperative security against emerging transnational threats. Honduras hosted and participated in a joint disaster relief training operation with U.S. military forces last year and a series of joint US/Honduran exercises (Horizons 06). During New Horizons, the two militaries worked together to construct clinics and schools to serve the Honduran poor.

¶24. (U) Approximately 575 U.S. service men and women, 12 civilian DOD employees, and 62 Locally Employed Staff (Hondurans) are currently stationed at Honduras, Soto Cano Air Base under the command of the Combatant Commander, U.S. Southern Command, as Joint Task Force Bravo (JTF-B). JTF-B has responsibility for interagency operations and supporting contingency operations such as disaster relief, humanitarian assistance, search and rescue operations, joint and combined training exercises, and counternarcotics operations in the assigned geographical area. In 1954, the USG and GOH signed a Bilateral Military Assistance Agreement that set forth their intention to work closely together to foster peace and security in the Western Hemisphere.

Embassy Tegucigalpa

¶25. (U) Embassy Tegucigalpa is a medium-sized post, employing approximately 119 U.S. citizens and 320 Locally Employed Staff (mostly Hondurans) among 14 USG agencies. The Peace Corps program, with approximately 192 volunteers, is one of the world's largest. The Mission maintains a Consular Agent in Honduras' second largest city and industrial center, San Pedro Sula.

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